Accessing Off-shore Sources and Capital Markets for Housing Finance in Africa: Strategies, Difficulties and Benefits

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Introduction

Access to and tapping appropriate sources of finance by institutions is crucial to realizing their important investment decisions. The central role financing decisions play in the activities of institutions- operational, investments, and other internal and external activities- has been variously recognized. Institutions that intend to succeed in today s competitive world therefore spend considerable time and financial resources in order to make correct decisions. Knowledge, information, innovation, globalization and competition drive the financial markets today as companies and individuals take positions that will enable them to optimize their returns and other benefits that accrue to them. The point that needs to be made here is that resources are scarce, that is the savings or surplus units increasingly find it difficult if not impossible to satisfy the financial needs of the deficit or the investment units of the economy at the national and international levels. The problem becomes complicated if and when an institution decides to play the game across its national or should we say natural boundaries. Not only are the requirements: legal framework, rates of return, risk profile, among other things, obviously differ across borders, some areas are also chronically and perpetually unable to attract any substantial level of savings, investments or investors confidence. The situation in Africa, where everything, including important indicators ranging from the living and environmental conditions, GDP per capita, GDP growth rate, to population growth rate, legal and regulatory frameworks are in pathetic conditions and remain far behind similar indicators of other regions of the world.

Emerging Issues

The housing finance situation in Africa is not different from the general poor economic performance which most countries have registered. Observers agree that there is a positive correlation between economic development or prosperity and the quality of housing and living environment which citizens of a country enjoy. As we are all well aware, if resources are fully employed, the only way to increase capital formation - that is any investment that increases the productive capacity of society- is to refrain from current consumption. It is noted that a traditional mortgage contributes to national capital formation and in fact entails charging both present and future incomes (savings) in order to enjoy better housing. But where the majority of

Africans live below the poverty line, current incomes are barely enough to satisfy the physiological needs, it is therefore important to ask ourselves whether all these talks, seminars and policies about housing finance, access and affordability are not a waste of our time, a misplaced priority, a case of jumping before crawling. Contrary to our own agenda and expectations those who are in dire need of improved housing have their ideas of how to provide it, which obviously does not include approaching any of the formal housing finance institutions (**HFIs**) represented here. Indeed, it is not surprising that the informal sector remains the largest source of housing finance in many countries, providing over 60% of the total housing finance. In a recent regional workshop on **Shelter, Poverty and Environment** in Eastern Africa organized by Shelter-Afrique in Nairobi participants, who included representatives from NGOs, CBOs, donor agencies, agreed that improved housing comes very low in the priority of the poor. Other issues such as security of tenure, improved health care, access to credit and education for children occupy higher priority. **Perhaps, we could be productive if our resources are channeled towards making the economy grow.**

Many of us are not shocked by these revelations since we are already aware of them. However, the question is whether formal financial markets are ineffective in solving not only the housing but also the economic development problems in Africa? The position you take will depend on the side of the divide you belong. Chances are that most of us will argue that the financial markets are extremely essential as the allocative engine for the limited resources available locally and globally efficiently. Where the markets are properly developed they have

provided increased access to and some level of efficiency in the use of limited resources of housing development. This is the position of Stiglitz (1993) and other economists see the financial markets as the **brain** of the entire economic system, the central focus of decision making and that housing finance must be part and parcel of it. HFIs should therefore as financial intermediaries be able to participant actively and competitively in these markets just like any other intermediary, for instance commercial banks. Others like Okpala (1993) see integrating housing finance into the mainstream national system although a desired goal but in the long term. They argue that given the nature of housing and the central issues involved some degree of support (subsidies) and incentives whether direct or indirect may be necessary.

Housing Finance in Africa

Housing, according to Diamond and Lea (1995), is a special consumer good, a special part of the financial markets and a key component of social welfare as well as a politically sensitive issue in most societies. Because of these characteristics, housing receives varied and diverse forms of treatment in different countries, ranging from heavy to mild degrees of support and incentives via subsidies to being left to the vagaries (irrational exuberance) of market forces. There is however a consensus that finance is one of the most crucial inputs in housing production and that the central issues are sustainable availability, affordability and accessibility of it to households (Okpala 1993). In order for these issues to be resolved, housing finance should not only be widely available, it should also be sufficient. We all agree that this is not the case either from the perspective of the households or the institutions. The need for housing finance or mortgage arise because there is a deficit in the investment needs (housing) of home seekers and their savings. Housing finance institutions therefore emerge to fill those needs by providing long-term funds to home sellers to purchase homes financed from savings mobilized from the surplus savings unit (governments, households, companies, foreign sources and so on) of the economy. How well this is done determines the success and sustainability of the housing finance systems. It is noted that these savings are insufficient and there are many institutions and sectors competing for them.

Housing finance belongs rightly to the capital market, that is the non-securities regiment, where savings institutions, building societies and mortgage companies are involved. Key financial instruments are mainly long term loans (mortgage loans). HFIs serve as the formal sources of housing finance and mobilize funds through savings. According to Okpala (1993) they account for between 5 percent and 20 percent of finance for housing in developing countries and usually cater for housing for the 20 percent of the income spectrum at the most. Many factors are responsible for the very limited role of HFIs in providing housing finance (Okpala 1993; Yahya 1992):

current characteristics of the institutions that constitute the system (established and funded by governments);

relative newness of the institutions;

a narrow resource base: resulting from very low real incomes;

restrictions on the maturity of deposits to be taken;

difficult macroeconomic conditions such as high inflation rates, economic recession, unemployment, amongst others;

institutions are urban-based and relate only marginally to the bulk of small holders, especially in non-urban areas;

availability of mortgage assets in the form of new houses in the primary markets or old houses changing hands in the secondary markets.

There are also what (Ayogu 1995) called the demand and supply factors that militate against developing a viable housing market in Africa. The affordability factor which is the main demand side problem emanates from the endemic troublesome political culture, suboptimal system of wages and income policies as well as the existing structure of income distribution. Typically a university professor in Kenya or Nigeria does not earn enough from his formal employment (regular salary) to meet the lending requirements for a mortgage loan in. He has to moonlight and undertake odd jobs to be able to provide a decent shelter for his family. **The important**

ratio of housing price to annual income remains very high for the low to middle income groups, generally any where between 5-20.

The supply side factors affect the availability of sufficient types of houses for different income groups. They include high cost of housing emanating from the escalating cost of construction, materials which in most instances are imported and finance as well as limited supply of serviced land, inefficient land registration, outdated building codes, land, institutional imperfections, amongst other thing. In the four countries, (Nigeria, Kenya, Zimbabwe, Botswana) recently studied by Shelter-Afrique, we found these problems that generally impede the development of market-oriented housing finance systems in varying degrees. While Nigeria lacks stable infrastructure and legal framework for the enforcement and protection of property rights, Kenya suffers from severe affordability due to low base incomes, high inflation and limited serviced but expensive land for housing development. Botswana also suffers from unemployment problems and over reliance on the public sector for employment, housing and other social services. The private sector remains weak to be able to make any impact on the housing market. Only Zimbabwe with some essential institutional frameworks and active primary market as well as a high level of continuing government commitment to shelter issues provides some hope for optimism.

Our paper does not attempt to address these issues since they will be covered by other speakers in this seminar. Suffice it to say however, that the following could be said about formal housing finance in most African countries (Okpala 1993; Ayogu 1995; Yahya 1992):

i) institutions are new, weak and generally deposit taking institutions in the form of building societies, mortgage banks, savings and loans associations and commercial banks; other sources of mortgage finance including mortgage banking, secondary mortgage market, mortgage backed securities, remain unexploited.

ii) these institutions account for less than 20% of the formal housing finance sources, are urban-based and cater for the higher income groups. The informal sector remains the largest source of housing finance in most cases accounting for over 90% of the housing finance.

iii) macroeconomic health and stability play a pivotal role in the success of the housing finance system. Institutions that operate in highly inflational environment may have their viability, effectiveness and sustainability threatened. Okpala (1993) considers inflation the **mortal enemy** of housing finance viability.

iv) government s visible and invisible hands created and supported most mortgage institutions that operates in most African countries either through direct funding, subventions, control or policy initiatives. Following SAP being implemented in most African countries, these institutions are more and more being required to operate independent of government and be integrated with national financial systems.

v) HFIs operate in poor legal and policy frameworks including tedious foreclosure laws and cumbersome systems of land titling and transfers, amongst other things.

vi) the development of HFIs is strongly related to the general sophistication of a country s financial system, which in turn is related to the overall economic development of that country.

vii) ineffective and in some cases confusing roles of governments in promoting and supporting housing finance systems exist in Africa. Researchers seem to agree that the incipient housing finance systems in Africa require governmental support. The problem however remains the form and extent of this support. There is evidence from other countries that have strong and successful systems that government support has been crucial.

Researchers also agree that housing finance problems dovetail with the following issues which must be reconciled or resolved in order to develop viable systems, namely (Renaud 1984 in Okpala 1993):

affordability of the households;

viability for the financial institutions: here issues of management, types of mortgage instruments, legal framework and so on become important;

resource mobilization for the expansion of housing sector.

We take the liberty to state that, all other things being equal, availability of finance will be the most critical input into developing a viable housing finance institution. The types and volumes of these funds should be such as to reach the majority of the population at affordable terms and conditions. The problem therefore how to tap these sources. Studies have also shown that household deposits or savings are sustainable long term sources of housing finance, are available and remain. We modify this statement slightly and posit that although these households deposits may be available, housing finance institutions most aggressively tap into them by using innovative instruments such as the stock exchange. This has become necessary because households with savings are consciously seeking higher returns for the investments while many market participants are competing for their savings. **How will the capital market help mortgage institutions?**

Capital Markets

Housing institutions and mortgages are capital market institutions and instruments respectively. They belong to the non securities segment of the capital market and by virtue of the long term nature of mortgages promote development activities. These institutions however remain largely depository in nature, using short term liabilities to finance long term assets. This asset/liability mismatch is a major risk which housing finance institutions continue to face in Africa. Indeed, it becomes even more complicated because HFIs rely more on pass book savings and less on pension funds. We are of the view that these problems can be solved through access to the securities market of the capital which usually provides the following advantages (Popiel, 1991):

mobilize long term savings to finance long term investment;

provide risk capital in the form of equity or quasi-equity to HFIs;

encourage broader ownership of productive assets;

improve the efficiency of capital allocation through a competitive pricing mechanism.

In spite of its role in improving access to long term finance, the capital market for housing funds has been poorly exploited because of the level of development of the few stock exchanges that exist in Africa today. Where the securities market is well developed, it is noted that more emphasis is placed on equities with the debt securities either non existent or insignificant. Rothschild (1997) had this to say about stock markets in Africa:

> Stock markets in Africa are still in their infancy. Market capitalization (Egypt which is the largest has a total market capital of US$ 18 billion ...) is small, turnover for most exchanges tiny and foreign participation limited. With economies growing and politics relatively calm, however, the more adventurous investors are finding the continent s equity story   irresistible .

It is however the potential of the stock market that is of importance here rather than the size. We therefore propose the market to HFIs not only as one of the many sources of finance - equity and debt - but also as a forum in which individuals and institutions can exchange risks (Stiglitz, 1994). In doing this we also recognize the position of Stiglitz (1994) that the stock market may have limitations as a venue in which funds are being raised to finance new ventures and expand existing activities as evidence available shows that institutions use more of other sources for raising funds.

The stock market, in spite of the reality, can assist HFIs to raise equity and more importantly debt for their lending operations. This has been tried in Kenya where the largest housing finance institution (HFCK) floated its shares on the Nairobi Stock Exchange (NSE) to attract new shares which subsequently reduced holding of its two main shareholders. The raising of debt, although rarely tried in Africa, has been successfully utilized in other developing countries (Malaysia, Trinidad and Tobago) to raise new funds for lending and to reduce liquidity risks. In order for the market for long term debts or fixed income securities to thrive, there is an important role for government to play. As noted earlier stable macroeconomic environment, in particular low inflation rate is a *sine qua non* for the development of a viable mortgage market, and even more important for the development of a fixed-income securities market. Where inflation remains high, a combination of mortgage insurance scheme and indirect subsidies such as tax relief on income earned on housing bonds will be imperative. Documented evidence shows that in all the countries where housing bonds or long term debts have been to finance housing, the governments have been instrumental to their development (Diamond & Lea, 1995). Of course all the basic institutional requirements for attracting investor confidence including sound management and underwriting procedures, good mortgage portfolio, and credit enhancement. The advantage of being out there and operating according to market standards is that it offers the institution the opportunity to get its act together. Once this market has been fully developed and a continuing pool of mortgages available then a secondary mortgage market or mortgaged backed securities could emerge.

Off shore Sources

External financial flows are no doubt crucial to the development and growth of any economy. Most African countries have instituted policies of attracting direct foreign investments or raising external loans and grants to finance their capital projects, mainly infrastructure and industries. These sources are also becoming very competitive and countries that hope to attract the right can of foreign direct investments should get their acts together. The use of these sources for housing is however more complicated given the   local nature   of housing as an asset. The current debt problems attest to either the continent s over reliance on offshore debt financing for its development activities or a poor use of these funds which resulted in a low level of foreign exchange generation capabilities.

Housing has benefited directly or indirectly from external sources, mainly in the form of bilateral and multilateral lending (soft loans) and grants. Government acted as the conduit for most of these funds which were on-lent to housing finance and development institutions. Both exchange and interest rates were more or less controlled and fixed which meant that HFIs were protected from the related risks. Funds flow from these external sources was significant and represented in some countries the only source of long term funds not only for housing but also for other development projects. The World Bank lending to Kenya for the Urban Development project in 1982 which included the Dandora site and service scheme helped to boost housing development in the country. In the same vein, the CDC s assistance to HFCK for the Buruburu Housing Estate was a turning point in the company s lending activities. These were before the advent of SAP. The situation has since changed with the markets liberalized and the government virtually disengaged from financing housing development.

We would like to ask whether access to external resource flows will help HFIs in Africa to improve their lending activities and reach more of the population than they currently do. **Are these external sources of funds available to and could be profitably exploited by HFIs? What are the difficulties and risks in being exposed to foreign exchange risks?**

Our position is that recent developments in the world brought about by globalization and technological advancement have considerably reduced barriers to unrestricted resource flows across borders, making it imperative for institutions to act locally but think globally. We further note that funds flows such as grants and soft loans will for a long time remain the only source for financing low-income housing in particular. HFIs will need to recognize these sources and design strategies for tapping them. But this must be done with caution given the requirements and risks associated with becoming part of the global village.

The recent turmoil in the South East Asian countries at least justifies this cautious optimism. Farrow (1997) summarises it thus: African sovereigns have yet to jump on the bandwagon of establishing benchmarks in the international capital markets. Most countries lack the economic and political qualifications necessary for market access, while some of the more likely candidates have not had the financial needs. A few of African countries (South Africa, Tunisia) are already active in the international bond market while others are potential aspirants, albeit for development projects other than housing.

It is recognized that housing is a non-foreign exchange generating asset which may pose unmanageable risks which will subsequently undermine HFIs if they were to borrow in foreign currencies. While this risk may be prevalent, it should be noted that there are possibilities for hedging these risks. Unfortunately these hedging instruments remain underdeveloped in Africa, perhaps due to the current volatility of the foreign exchange market. Underwriting mortgages denominated in foreign currency could help HFIs reduce forex exposures while multilateral lending institutions such world bank, the African Development Bank, Shelter-Afrique could design instruments (for instance a reserve fund) that would enable HFIs access this alternative source of funds. **Our concern here is on sustainable access and availability rather than cost.** This is in recognition of the fact that investors globally seek rates of return that are commensurate with the risks of the investments and that opportunities for arbitrage are quickly whittled away in this efficient global market, at least that is what the theory tells.

Another strategy that could reduce foreign exchange risk is to utilize the external resource flow as a short term construction finance while long term mortgage is generated locally. After the construction, proceeds should be externalized and lent to industries or projects that generate foreign exchange.

We note another aspect of international financial flows which is quite important but not properly harnessed by HFIs: the financial flows from expatriate Africans working outside the continent. Yahya (1994) estimates that these resources are significant and currently finance a substantial proportion of new constructions in East African coastal cities (Mogadishu, Mombasa, Dar es Salaam, Zanzibar, and so on). Similar inflows are witnessed in Ghana, Nigeria, Guinea, Egypt, and in other countries with a large number of their citizens outside their borders. If properly harnessed, this source could provide sustainable funds for mortgage lending activities.
Another important way of assessing not only off-shore financial resources but also technical assistance is to establish cooperation with HFIs in advanced and developing countries in the World. Short of copying their successful systems, African HFIs have something to learn from

the HDFC of India, the Government Housing Bank in Bangkok and the Cagamas Berhad (the National Mortgage Corporation) in Malaysia. Even within Africa there are HFIs that have interesting stories to tell. The Housing Finance Company of Kenya (HFCK), in spite of the general problem of affordability, has developed a fairly reliable system of mobilizing resources for its mortgage lending activities even during the very volatile periods of 1992-1994 in Kenya. It successfully raised (or increased) its equity through the Nairobi Stock Exchange and had benefitted from off-shore funds. HFCKs development programme with developers and commercial banks is worthy of detailed study.

In the Francophone West African countries, we have also seen successful strategies used to tap into local and offshore financial markets. The Banque de l Habitat du Senegal, SNHLM and SICAP of Senegal continuously tap into offshore funds for its housing development and long term mortgage activities. They combine sound underwriting procedures with an active presence in the development market to keep afloat and remain viable even after the devaluation of the CFAF. The ability of these institutions to move beyond their borders for funds may however be attributed to the relative stability of their currency, the CFAF, against other currencies. Although this has been threatened by the devaluation of CFAF, the HFIs in francophone Africa seem to have performed better than their anglophone counterparts.

Role of Shelter-Afrique

Shelter-Afrique, we believe is a unique agency on the continental housing scene. It is an intergovernmental organization whose primary purpose is to mobilize finance and channel it to the development of housing. Shelter-Afrique works with both public and private sector institutions in the areas of real estate development, mortgage financing, institution building, and local building materials development. Its main financing instruments include direct loans, lines of credit, equity investment and technical assistance. Lending is denominated in foreign currency which limits the company s ability to reach many HFIs in Africa mainly because of the foreign exchange risks highlighted earlier.

We however see an increasing role for Shelter-Afrique in finding solutions which will make it possible for HFIs to tap these resources. The starting point lies with the HFIs themselves which must strive to establish on their own a reasonable level of viability and capacity to originate, underwrite and service mortgage loans. **They should create and enjoy some autonomy and independence in these functions, be able to respond and adapt to changes in economic circumstances as well as have strategies that are forward looking.** For this to be possible, appropriate legal and regulatory frameworks have to be devised and the relevant institutional framework created (Yahya 1994).

This may look simple but our experience in working in this area suggests otherwise. For instance, there are no institutional and legal frameworks to support mortgage institutions in Tanzania. There are in fact limiting factors that adversely affect the creation of market oriented housing finance systems including:

Poor macro-economic situation and affordability problems for example in Kenya.

Inadequate legal framework that protects property rights and apparent lack of primary HFIs to originate a continuing pool of mortgages, for instance in Nigeria.

Weak demand side factors emanating from high unemployment and public sector dominance, for example in Botswana.

Lack of proper land registration, titling and administration and inadequate mortgageable assets in Guinea.

Conclusion

We would be fooling ourselves if we believe that HFIs will be in a position to begin to tap into the capital markets in the very near future. There this obviously still a long way to go before African HFIs can become active players in these markets. In the meantime however the critical task of establishing viable institutions that understand what mortgage origination, underwriting and financing, that is the whole primary market, is all about. This will ensure that there is a critical mass of mortgages that will make capital markets activities viable.

Even more important is the need to develop mortgage instruments or contracts that address the needs of all segments of the market by adopting customer focussed strategies and innovative instruments. This is the primary responsibility of HFIs themselves. It is only when HFIs have shown sufficient potential to become that all other resource-related problems could begin to be solved.

Finally we reiterate the important role the government could play in facilitating the establishment of viable housing institutions in Africa. It is however regrettable that governments have interpreted disengagement to entail abandoning key social responsibilities such as decent housing and living for the people. Even as we pursue SAP through different stages and while we wait to enjoy its promises of growth and prosperity, the should not forget its contract with the people. This has been and will continue to be the hallmark of a socially and politically responsible government. It is strong and noticeable in all countries that have succeeded.

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